No. 10584 12

IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

NORTHWESTERN MUTUAL FIRE ASSOCIATION, a corporation, *Appellant*,

vs.

UNION MUTUAL FIRE INSURANCE COMPANY OF PROVIDENCE, RHODE ISLAND, a corporation, *Appellee*.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

APPELLEE'S BRIEF

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APPELLEE'S BRIEF

I. JURISDICTION OF THE DISTRICT COURT AND OF THIS COURT

The jurisdictional facts are established by the complaint (Tr. 2), amended complaint (Tr. 27), answer to amended complaint (Tr. 58), petition, notice and bond for removal (Tr. 15-22), order on removal (Tr. 23), and the District Court's Findings I and II (Tr. 67).

On June 22, 1943, the District Court made and entered its Findings of Fact and Conclusions of Law in favor of Appellee, the same being reported in 50

F. Supp. 785 (See also: Tr. 66). Judgment in favor of the Appellee was entered on the same date (Tr. 80).

The statutory provisions believed to sustain the jurisdiction of the District Court are: 28 U.S.C.A., §§41(1), 71, 72, 81. The statutory provisions believed to sustain the jurisdiction of this Court are: 28 U.S.C.A., §§225, 861(a), 861(b).

II. STATEMENT OF THE CASE

A. Statement of the Issue

The sole question presented by Appellant's opening brief is whether certain findings of fact made by the District Court are supported by the evidence. Appellant's Specification of Errors is addressed to the following Findings: Findings Nos. VIII, XII, XIII, XIV, XV, XVI and XVII (Appellant's Brief, pp. 13-16). Appellant in its Specification of Errors mentions the conclusions of law and judgment, but does not contend that the findings do not support the conclusions and judgment, or that the conclusions do not support the judgment. The question involved is purely factual.

The gist of the case is this: Appellant sues on a written contract, which by its express terms negatives Appellant's cause of action, but Appellant contends that, by custom and usage in the insurance business, the terms of the contract have a meaning different from their meaning in ordinary English. The District Court on conflicting evidence made findings contrary to Appellant's contention. Are the District Court's Findings "clearly erroneous?"

We submit that the Findings are supported by the great preponderance of the evidence.

B. Statement of the Facts

The Appellant in its Statement of the Case has summarized the pleadings and made some reference to the evidence in the case. We believe, however, that for a clear understanding of the issues a further statement of the facts established by the evidence is of importance.

Appellant's case is based solely upon contract—*a particular contract which is in writing.* Appellant sues for a sum which it claims it is entitled to by virtue of the terms of that written contract. The contract is set forth in full in the plaintiff's amended complaint in this action (Tr. 28). The contract, which is dated January 1, 1940, is a reinsurance agreement between Appellee, as the Reinsuring Company, and Appellant, as the Reinsured Company. This type of reinsurance agreement is commonly referred to in the insurance business as a "*Treaty,*" and will be so referred to in this brief.

In *Article I* of the Treaty it is provided that Appellant agrees to cede reinsurance to Appellee, and that Appellee agrees to accept such reinsurance, on account of liability arising under policies, binders or entries of the Appellant covering property located anywhere in the United States of America and/or the Dominion of Canada, subject to the terms and conditions of the Treaty (Tr. 28).

Article VII of the Treaty provides that reinsurance thereunder shall be ceded on the *daily report and account current plan,* and that liability shall be made effective by the specific written designation of the reinsuring company by the reinsured company (Tr. 31).

Article VIII of the Treaty provides, among other things, that cessions of reinsurance by Appellant to Appellee under the Treaty *shall in no case and at no time exceed the amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property* (Tr. 32). This so-called "net retention clause" is a vitally important part of this reinsurance Treaty (Tr. 103, 115).

Article XIV of the Treaty provides that, if in case of loss it should appear that the amount ceded to the Appellee by the Appellant is in excess of the amount authorized in Article VIII of the Treaty, the amount reinsured with the reinsuring company shall be reduced in such manner that the liability of the Appellee shall not exceed the amount for which it would have been liable had the provision for net retention in Article VIII of the Treaty been complied with (Tr. 35).

Appellant in its amended complaint (Tr. 27) alleges that it ceded to Appellee pursuant to the Treaty, \$50,000 of reinsurance covering the Tacoma Narrows Bridge in the State of Washington; further alleges that Appellant, as direct insurer, was compelled to pay a loss upon the bridge and prays for judgment against Appellee in the sum of \$40,148.72, Appellee's alleged share of the loss.

Appellee in its answer (Tr. 58) alleges that under the express terms of the Treaty, Appellant is entitled to collect from Appellee no more than \$25,624.31, plus interest at six per cent per annum to June 21, 1942, or a total amount of \$26,897.55. *This amount was tendered and paid by Appellee to Appellant on*

June 20, 1942, at the time Appellee's answer was served and filed, and was accepted by Appellee on that date without prejudice to the rights of either party (Tr. 64, 77).

During the year 1940 the Washington Toll Bridge Authority constructed a single-span suspension bridge across the Tacoma Narrows, near Tacoma, Washington, known as the Tacoma Narrows Bridge (Tr. 68). Appellant directly wrote $350,000 of insurance on this bridge, insuring the Washington Toll Bridge Authority against loss or damage by various risks, including windstorm and collapse, upon the bridge and approaches (but excluding the administration building). Appellant specifically reinsured $300,000 of that amount with various reinsurers, including Appellee, under its various reinsurance treaties (Tr. 68).

On May 31, 1940, Appellant wrote Appellee advising it of the insurance to be written on the Tacoma Narrows Bridge and asked Appellee how much the latter was prepared to accept from Appellant by way of reinsurance on the risk (Tr. 40).

On June 10, 1940, Appellant sent Appellee a telegram (Defendant's Exs. A-1, A-2; Tr. 92, 93), stating in part:

> "Further information just received indicates P. M. L. about 50%. *We will retain $50,000.* Please wire your authorization." (Italics ours)

To appreciate the importance of this wire it is necessary to refer again to Article VIII of the Treaty, providing that cessions of reinsurance by Appellant to Appellee under the Treaty shall *in no case and at no time exceed the amount retained net without reinsur-*

> Northwestern's net without reinsurance is not $50,000 and your actual loss will therefore be less than the amount indicated, we would appreciate it if you would advise us exactly what your net loss will be on the risk." (Italics ours).

On October 1, 1941, Appellant wrote Appellee (Defendant's Ex. A-8, Tr. 97) answering Appellee's letter of September 8, 1941. In this letter of October 1 Appellant explains that, at the time the policy was written and the reinsurance placed, Appellant had in effect an *excess of loss reinsurance contract*, whereby it was reinsured to the extent of *90 per cent of all loss sustained by it in excess of $30,000 on the Tacoma Narrows Bridge.* Appellant's letter states:

> "The facts of the matter are that at the time this policy was written and the reinsurance placed, the Northwestern had in effect a catastrophe excess *reinsurance contract* whereby we were reinsured to the extent of 90% of all loss in excess of $30,000 in any one catastrophe, although in establishing our net line *this fact was given no consideration whatsoever.*" (Italics ours)

The excess of loss reinsurance contract referred to in Appellant's letter of October 1, 1941, has been introduced in evidence in this case as Plaintiff's Exhibit 1 (Tr. 197). The contract, dated April 19, 1940, is between Appellant and Lloyd's.

It is important to note that, by the terms of this excess of loss reinsurance contract with Lloyd's, Appellant was *reinsured* for *any net amount for which it might become liable in excess of $30,000 in any one loss, and then only for 90 per cent of the amount in*

excess of $30,000. It is important to note, too, that this excess of loss reinsurance applied *in the event of any one loss,* whether *only one structure was involved* or whether a number of separate structures were involved.

This excess of loss reinsurance admittedly applied to the Tacoma Narrows Bridge as a single structure and, as we shall hereafter note, *the absolute top liability of Appellant in the event of any one loss to the Tacoma Narrows Bridge was, by virtue of the existence of Plaintiff's Exhibit 1, limited to $32,000.*

Appellant throughout its brief refers to Plaintiff's Exhibit 1, as "catastrophe excess reinsurance." As will be noted hereafter, Plaintiff's Exhibit 1, as applied to the Tacoma Narrows Bridge, is properly classified as "*excess of loss reinsurance,*" and not as a catastrophe cover.

Appellant's letter of October 1, 1941 (Defendant's Ex. A-8, Tr. 97), from which we have quoted above, was the first notice given by Appellant to Appellee that Appellant's net retention on the Tacoma Narrows Bridge was only $32,000 (that is, $30,000, plus 10 per cent of $20,000), instead of $50,000 as warranted (Tr. 104, 105). This notice was received by Appellee almost a year after the loss of the Tacoma Narrows Bridge.

On October 10, 1941, Appellee wrote Appellant (Defendant's Ex. A-9, Tr. 99) acknowledging receipt of Appellant's letter of October 1, 1941 (Defendant's Ex. A-8, Tr. 97) and stating in part:

> "On the basis of this information, it would appear that we have been overlined on this risk,

> as our reinsurance contract with you, under which you cede business to us, provides that cessions shall, in no case, exceed the amount retained net, without reinsurance by the Northwestern.
>
> "On the basis of your letter, we believe that the actual net amount retained by the Northwestern without reinsurance was only $32,000.00 instead of $50,000.00 as indicated in the certificate and, on the basis of the contract, our Union line should also have been not exceeding $32,000.00 which, on the basis of an approximate 77% loss, would make our loss payment only approximately $25,000.00, instead of $38,461.54 as called for by the proof of loss submitted."

Had the provision for net retention in Article VIII of the Treaty been complied with by Appellant, Appellee would have been ceded $32,000 and would have been liable for its pro rata share of the loss computed on the basis of a $32,000 cession.

The share of the loss due Appellant from Appellee, computed in accordance with Article XIV of the Treaty (Tr. 35) was $24,615.38, plus $1,008.93 for Appellee's share of the adjustment expenses. Thus the total amount due Appellant from Appellee was $25,624.31 (Tr. 77).

Appellee on June 20, 1942, paid to Appellant this sum of $25,624.31 plus interest at six per cent per annum to June 21, 1942 (Tr. 64, 77).

Throughout this case Appellant has contended, in effect, that the words "*amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property*," as used in Article

VIII of the Treaty, really means "amount retained net without reinsurance, *but disregarding excess of loss reinsurance.*"

This contention, in essence, is an attempt by extrinsic evidence to modify and amend Article VIII of the Treaty.

At the trial Appellant demanded the right to introduce extrinsic evidence of alleged custom and usage on this point, and the Court permitted the Appellant to orally amend its amended complaint by adding a paragraph alleging that by custom and usage an exception should be read into Article VIII (Tr. 165, 168).

Thereafter the District Court permitted the Appellant, over Appellee's continuing objection, to introduce extrinsic evidence on this point. This extrinsic evidence consisted of the testimony of Appellant's vice president, Mr. Beall, and of two other witnesses, Messrs. Blaise and Sullivan.

Appellant's counsel asked these witnesses to state "what, in insurance language, is meant by the term 'net retention,' or as in this contract, an amount retained net without reinsurance at its own risk and liability on one specific property" (Tr. 164, 186, 213). The three witnesses made similar answers, of which the following by Mr. Blaise is an example: "The net retention is that amount of liability on a given risk remaining to the account of the primary company after the deduction of all specific reinsurance from the gross line relating to that particular risk" (Tr. 170).

Thereafter the District Court permitted Appellee, without waiving its continuing objection to the admissibility of testimony of custom and usage, to introduce testimony in surrebuttal upon this point. The Appellee introduced the testimony of five of the leading reinsurance authorities in the United States, Messrs. Towers, Newman, Pryce, Stewart and Thompson, all disinterested reinsurance experts, in no way connected with the Appellee (Tr. 242, 261, 284, 298, 307). All of these witnesses testified that under the customs and usages of the insurance business the term "*amount retained net without reinsurance by the reinsured company at its own risk and liability upon the same property*, as used in Article VIII of the Treaty, *means what it says* — that is, the maximum amount which the ceding company could lose, at its own risk and liability, in the event of a total loss of the Tacoma Narrows Bridge, taking into consideration excess of loss reinsurance, such as Plaintiff's Exhibit 1 (Tr. 197), as well as pro rata reinsurance (Tr. 243, 245, 251, 260, 266, 286, 287, 300, 301, 316, 318, 319, 336). These witnesses testified that Appellant's actual net retention was $32,000, *not* $50,000 (Tr. 111, 147, 160, 180, 182, 193, 246, 266, 288, 302, 303, 329, 330). All of the expert witnesses, including those called by Appellant, testified that the highest possible loss which Appellant could sustain at its own risk and liability in the event of a total loss of the bridge, taking into account Appellant's excess of loss reinsurance, was $32,000 (Tr. 180, 193, 194).

This testimony regarding custom and usage will be discussed later under Section III-A(2) of this brief.

The District Court on June 22, 1943, made and entered its Findings of Fact and Conclusions of Law in favor of the Appellee. These findings of fact and conclusions of law are reported in 122 F.(2d) 699, and will be found on pages 66 to 80 of the transcript in this case.

On the basis of these Findings the District Court on June 22, 1943, entered its Conclusions of Law and Judgment in favor of Appellee (Tr. 79-81).

III. ARGUMENT

SUMMARY

A. The District Court's Findings of Fact Are Clearly Supported by the Great Preponderance of the Evidence.

(1) It was Appellant's obligation to observe the utmost good faith in correctly stating its actual net retention to Appellee;

(2) Whether we look to the terms of the Treaty alone, or look further to the evidence of custom and usage, it is clear from the evidence that Appellant failed to correctly state its net retention to Appellee;

(3) The evidence establishes that Appellee had no notice or knowledge of Appellant's failure to correctly state its net retention until after the loss of the Tacoma Narrows Bridge;

(4) Appellant's "two-risk" theory and its contention regarding "P. M. L." are clearly contrary to the preponderance of the evidence.

A. THE DISTRICT COURT'S FINDINGS OF FACT ARE CLEARLY SUPPORTED BY THE GREAT PREPONDERANCE OF THE EVIDENCE.

Findings of fact will not be set aside on appeal unless clearly erroneous, and due regard should be given to the opportunity of the trial court to judge the credibility of the witnesses.

Rule 52(a), Rules of Civil Procedure for the District Courts of the United States;

Occidental Life Insurance Co. v. Thomas (C.C.A. 9) 107 F.(2d) 876;

Wittmayer v. United States (C.C.A. 9) 118 F.(2d) 808;

Crowell v. Baker Oil Tools, Inc. (C.C.A. 9) 99 F.(2d) 574;

Storley v. Armour & Co. (C.C.A. 8) 107 F.(2d) 499.

A review of the evidence will clearly establish that the District Court's Findings are supported by the great preponderance of the evidence.

(1) It was Appellant's Obligation to Observe the Utmost Good Faith in Correctly Stating its Actual Net Retention to Appellee.

It is well established by the evidence, and by all the authorities on reinsurance, that the net retention clause in a reinsurance Treaty, such as the clause found in Article VIII of the Treaty in suit, and strict compliance with that clause by the ceding company, are of vital importance to the reinsurer. A reinsurance treaty, such as the Treaty involved here, grants extensive rights to the ceding company to bind the reinsurer. The ceding company is on the ground,

makes the investigation and has all the underwriting details of the property involved. The reinsurer does not have these details. The reinsurer must therefore rely upon the judgment, diligence and good faith of the ceding company in the investigation and evaluation of the risk, the placing of the insurance and the making of all investigations, adjustments and settlements in the event of loss (Tr. 103, 115, 179, 193, 233, 246).

The net retention clause therefore requires that the reinsured company shall maintain a stake in the particular insurance. In the case at bar, the reinsurance treaty requires that the reinsured must retain a stake in the insurance which is identical with the amount of the insurance ceded to the reinsurer. Thus the net retention clause is the reinsurer's best guaranty that the ceding company will perform its full duty at all times.

It is also well established by the authorities that the reinsured must at all times exercise *the utmost good faith* in complying with its net retention obligation *and in fully advising its reinsurer with respect to all relevant facts relating thereto.*

In "Approach to Reinsurance," by H. Ernest Seer, it is stated on page 31:

> "It is evident that this intimate relation can prosper only on the basis of complete honesty and profound mutual trust. This feature cannot be emphasized enough. *'Good faith' is the backbone of the whole system.* All underwriting decisions are so exclusively with the ceding companies that the reinsurer, after conclusion of the

treaty, has no way of influencing the selection of risks except by friendly, voluntary cooperation of the ceding company. The latter could find innumerable occasions for circumventing the provisions of the treaty (for instance, in the apportionment of risks), with very little fear of being detected. Even under obligatory treaties situations can arise where the reinsurer's liability is doubtful, as in the case of a loss occurring prior to the determination of the ceding company's net retention. Finally, a treaty, particularly a large one, creates such important financial relations between the parties that the failure of one company may very well result in a similar fate to the other." (Italics ours)

In "The Law and Practice of Reinsurance," by C. E. Golding, Buckley Press, Ltd., 1937, on page 13, it is stated:

> "The doctrine of good faith is of universal application as much to reinsurance as to direct insurance. *It calls for the disclosure by the ceding company to the reinsurer of every material fact relating to the risk to be reinsured.*" (Italics ours)

Further on page 14 of his treatise Mr. Golding states:

> "A fundamental rule of reinsurance is expressed as follows—The foundation of a reinsurance is—
>
> "(1) *Full information, so far as possessed by the ceding company, as to the risk on which the reinsurance is requested*:
>
> "(2) *Full information as to the amount retained by the ceding company on the identical property on which the reinsurance is requested.*" (Italics ours)

Futher on page 15 of the same treatise Mr. Golding states:

> "It suffices here to say that any failure to disclose such material facts would be a sufficient ground to enable the reinsurer to avoid the contract. * * * Every time a cession is made under a treaty this initiates an actual reinsurance, and though the details which have to be communicated to the reinsurer are limited, yet in the general operation of the Treaty *the ceding company is bound to exercise the utmost good faith* towards its reinsurer, even though this must occur after the contract was completed." (Italics ours)

John H. Magee, in his treatise "General Insurance," 1939, states on page 100:

> "*The Net Retention.* When for any reason a direct writing company desires reinsurance, the reinsurer is interested in knowing to what extent the ceding company remains interested in the risk. The remainder carried by the ceding company after all reinsurance has been placed is referred to as the net line or the net retention. Since the reinsurer in most reinsurance agreements depends upon the ceding company to do the underwriting, the reinsurer would be unwilling to assume any risk which the ceding company itself refused to assume. For this reason, where reinsurance treaties are effected, a clause may be inserted stipulating that the total amount to be reinsured under the treaty shall depend upon the net retention, and it may further be stipulated that the reinsurer shall not be called upon to pay on any loss an amount in excess of that paid on the loss for its own account by the direct writing company. While some companies ob-

ject to the clause as involving an excessive amount of paper work, it is nevertheless recognized as a basic principle in the business of reinsurance that the ceding company should place no liability upon the reinsuring company that it is unwilling to share."

In Thompson on Reinsurance, Commerce Clearing House, Inc., 1942, page 113, it is stated:

> "*While excess cover may be used by a reassured, it ought to inform its reinsurers of any action taken by it in this connection so that reinsurers can always have knowledge of the reassured's self-retentions under a treaty.*" (Italics ours)

In the case of *Columbian National Fire Insurance Co. v. Pittsburgh Fire Insurance Co.* (Mich.) 210 N. W. 258, 259, the reinsurance treaty involved was similar to the Treaty involved in the present case. Referring to the obligation of the reinsured company the court said:

> "*The parties were not dealing at arm's length. Under the contract plaintiff (the reinsured company) occupied a fiduciary position demanding fairness and open disclosure of all reinsurance reducing its agreed retention of risks, and, if its failure to disclose was intentional, it constituted a fraud in the eye of the law.*" (Italics ours)

See also:

> *Traill v. Baring* (England) 33 Law Journal (Chancery) page 521; 10 Jur. (N.S.) 377; affirmed by the House of Lords on Appeal, 33 Law Journal (Chancery) page 525.

The Appellee, as reinsurer, had a vital interest in

the Appellant's actual net retention on the bridge, giving consideration to *all reinsurance* that was applicable to that bridge, regardless of whether it was pro rata reinsurance or excess of loss reinsurance. *Appellee was just as much injured by Appellant's failure to take into consideration its excess of loss reinsurance as it would have been had Appellant failed to take into consideration its pro rata reinsurance on the bridge.*

(2) Whether We Look to the Terms of the Treaty Alone, or Look Further to the Evidence of Custom and Usage, It is Clear From the Evidence That Appellant Failed to Correctly State Its Net Retention to Appellee.

The District Court after hearing all of the testimony on custom and usage, found in its Finding XVI (Tr. 77-79) that the terms of Article VIII of the Treaty were plain, clear and unambiguous, and did not permit of modification, amendment or interpretation by extrinsic evidence. It is important to note, however, that the Court's Finding XVI did not stop there. The Court further found that in any event, under the customs and usages of the insurance business and in the insurance world, the term "amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property reinsured by the said reinsured company with the reinsuring company," as used in Article VIII, *does include and does apply to excess of loss reinsurance such as Plaintiff's Exhibit 1*, and *means what it says*, namely: The amount retained net by the reinsured company at its own risk and liability on the

same property reinsured by the reinsured company with the reinsuring company, after deducting all reinsurance, *including excess of loss reinsurance such as Plaintiff's Exhibit 1.*

In short, the District Court specifically found that, considering all the testimony offered by both parties on the question of custom and usage, the established custom and usage in the insurance business does not support the allegations of Appellant's trial amendment but on the contrary supports Appellee's position in this case.

Pages 18 to 21 of Appellant's brief are devoted to the proposition that "oral testimony is admissible to define the meaning of words used in an agreement where it appears that under the circumstances the words were used in a sense different from their ordinary meaning." The District Court in its Finding XVI finds from the evidence that the words used in Article VIII of the Treaty were *not* used in a sense different from their ordinary meaning (Tr. 77-79).

It is, of course, well established that before a party can successfully introduce evidence of custom and usage to alter, vary, modify or construe a complete written contract, he must first prove by clear and convincing evidence the following facts: (a) That there is an ambiguity in the written contract which requires construction; (b) that there was an established custom bearing upon the point at issue at the time the contract was entered into; and (c) that such established custom was either known to and relied upon by both parties at the time the written contract was

entered into, or the custom was so universal in its application that the courts must conclusively presume that both parties knew of the custom, relied upon it, and acted upon it in entering into the contract.

> 25 C.J.S., §8, p. 80; §24, p. 112; §33, pp. 126, 128;
>
> *Hearn v. New England Mutual Marine Ins. Co.*, 11 Fed. Cas. 969, 970;
>
> *Fidelity & Deposit Company of Maryland v. Washington Life Insurance Co.*, 193 Fed. 512;
>
> *Orient Mutual Insurance Co. v. Wright*, 17 L. Ed. 505;
>
> *Aetna Insurance Co. v. Sacramento-Stockton S. S. Co.* (C.C.A. 9) 273 Fed. 55;
>
> *Trans-Atlantic Shipping Co. v. St. Paul Fire & Marine Insurance Co.* 9 F.(2d) 720;
>
> *Smith v. Providential Savings Life Assurance Society*, 65 Fed. 765.

We have noted that Article VIII of the Treaty (Tr. 32) provides that cessions under the Treaty shall in no case and at no time exceed *the amount retained net without reinsurance by the reinsured company at its own risk and liability.* The Appellant seeks to add an amendment to this clause that will read in substance —"*but disregarding excess of loss reinsurance.*"

All of the authorities on reinsurance, and all of the witnesses in this case, agree that an excess of loss reinsurance contract such as Plaintiff's Exhibit 1 (the contract between Appellant Northwestern and Lloyds) *is but one kind of reinsurance* (Tr. 192, 248, 268, 289, 304, 305, 309, 313, 314).

Plaintiff's Exhibit 1 therefore comes squarely with-

in the term "*without reinsurance*" found in Article VIII of the Treaty (Tr. 32). This meaning of Article VIII is re-enforced, if any re-enforcement were necessary, by the words "*at its own risk and liability.*" It is obvious that, giving effect to Plaintiff's Exhibit 1, all that Appellant retained net on the Tacoma Narrows Bridge *at its own risk and liability* was $32,000.

How can Appellant possibly argue, with any semblance of logic, that it retained net $50,000 "*at its own risk and liability*" on the bridge, in view of the fact that Lloyd's, in Plaintiff's Exhibit 1, guaranteed to relieve Appellant of liability to the extent of 90 per cent of any loss on the bridge exceeding $30,000?

The clear meaning of the *amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property*, is further re-enforced, if any further re-enforcement were necessary, by the fact that the first clause of Article VIII of the Treaty, which specifies the *kind* of insurance or reinsurance *which Appellant may cede to Appellee*, provides that it may be any kind of insurance or reinsurance, without limitation as to class, *excepting excess and catastrophe reinsurance* (Tr. 32). *No such exception, however, is contained in the subsequent clause of Article VIII which defines net retention.*

Thus, even if there were any doubt about the definition of net retention contained in Article VIII, the specific exception of excess of loss reinsurance from the first clause of Article VIII, and the failure to include such an exception in the net retention clause of Article VIII, further demonstrates that no

such exception was intended in the net retention clause.

However, conceding for the sake of argument, that the Appellant was entitled to introduce extrinsic evidence for the purpose of proving, if it could, an established custom or usage sufficient to change, modify or construe the net retention clause, the evidence introduced by the Appellant in this connection was, as the District Court properly found, insufficient to establish such a custom or usage.

The Appellant introduced the testimony of three witnesses in this regard. These witnesses were Mr. Beall, vice president of Appellant, Mr. Sullivan and Mr. Blaise.

Mr. Blaise was asked (Tr. 164):

> "Q Will you state to the court what, in insurance language, is meant by the term 'net retention,' or, as in this contract, an amount retained net without reinsurance at its own risk and liability on one specific property?"

Over the objection of Appellee, Mr. Blaise was permitted to answer as follows (Tr. 170):

> "A The net retention is that amount of liability on a given risk remaining to the account of the primary company after the deduction of all specific reinsurance from the gross line relating to that particular risk."

During the examination of Mr. Blaise on direct he further testified (Tr. 172):

> "Q Is catastrophe excess insurance written on specific losses or not?
>
> A No. They are general covers, applying to all

net retained lines, but not applying to any specific risk."

Nevertheless, on cross-examination, Mr. Blaise was forced to admit that, viewing the situation as of the date Appellant made the cession to Appellee, the highest possible loss which Appellant could sustain, by reason of its insurance on the Tacoma Narrows Bridge, at its own risk and liability as the result of one loss, was $32,000 (Tr. 180).

During his cross-examination Mr. Blaise further testified (Tr. 180):

> "Q *On that assumption I am asking you to make, there is no conceivable set of circumstances that could have increased their (Appellant's) liability at their own risk above $32,000 for loss from one catastrophe on the bridge, is there?*
>
> A *No, I think not.*"

Mr. Blaise further testified (Tr. 182):

> "Q And assuming a total loss regardless of the risk?
>
> A Northwestern would have paid the first $30,000 and 10% of the balance up to $50,000.
>
> Q Or, $32,000?
>
> A Correct."

Mr. Sullivan was asked by Appellant on direct examination (Tr. 186):

> "Q Are you familiar, Mr. Sullivan, with the meaning in the insurance trade of the term 'net retention' as we have used it here in this trial? * * * Will you explain to the court what that is?"

Over the objection of the Appellee Mr. Sullivan was permitted to testify as follows (Tr. 186):

> "A Net retention as it is used in the trade

> means the amount which a company would retain of the risk for its own account of a policy of insurance which would have been issued for possibly a larger amount, and they may have ceded it off or given off some of the risk to other companies through means of reinsurance."

Mr. Sullivan further testified that the existence of "catastrophe" reinsurance is not, to his knowledge, considered as determining net retention (Tr. 187).

As will clearly appear hereafter, Plaintiff's Exhibit 1, the contract between Appellant and Lloyd's, as applied to the Tacoma Narrows Bridge, was *not* a catastrophe cover, it was *excess of loss reinsurance.*

Mr. Sullivan, in defining what he meant by "catastrophe reinsurance," stated:

> "Catastrophe reinsurance covers the whole spread of the company's business. As a matter of fact it is generally thought of as more or less surplus reinsurance. * * * It applies to no particular risk, but applies to the whole spread." (Tr. 187)

Of course, Plaintiff's Exhibit 1 (Tr. 197) *admittedly did apply to the Tacoma Narrows Bridge as a particular risk.*

Futher, Mr. Sullivan testified (Tr. 188):

> "The consideration of catastrophe insurance is not applicable because the question of whether or not catastrophe insurance will come into play is not known until the loss is determined."

It is quite clear that Mr. Sullivan based his testimony upon an absolute misconception of Plaintiff's Exhibit 1. Plaintiff's Exhibit 1 did apply to the bridge as a particular risk. Furthermore, Plaintiff's Exhibit

1 had an attachment point (or "first loss retention") of $30,000, which was below Appellant's warranted net retention of $50,000. All of the Appellee's witnesses testified, and all of the Appellant's witnesses were forced to admit, that in view of the existence of Plaintiff's Exhibit 1 the highest possible loss which Appellant could sustain in the event of total destruction of the Tacoma Narrows Bridge was $32,000 (Tr. 111, 147, 160, 180, 182, 193, 246, 266, 302, 328, 329, 335, 338). The fact was readily determinable by Appellant at the time it made the cession to Appellee, and should have been clearly stated in its daily report (Tr. 160, 161).

Mr. Beall, Appellant's vice president, was requested on direct examination "to tell the court the meaning in insurance language, and in the insurance business, of the term 'net retention,' as we have used it here in this trial." He answered: "Net retention refers to the amount of the primary insurance for which the primary company is liable, less the amount of specific reinsurance ceded." (Tr. 213)

It will be appreciated that this type of testimony wherein the witness expresses his understanding of the general term "net retention," in disregard of the detailed and specific definition of net retention contained in the Treaty in suit, is of little, if any, aid to the Court. As will be noted hereafter, definitions of net retention in treaties and reinsurance contracts differ greatly. It would sound the death knell of written contracts if witnesses were permitted to nullify the definitions specifically set forth in those contracts by giving vague, general definitions of their own.

Mr. Beall further testified that possible recovery under *catastrophe* contracts is disregarded in respect to net retention (Tr. 213). He stated (Tr. 214):

> "It has no application to an individual risk, but rather it applies only to a catastrophe." (Tr. 213-14)

Mr. Beall makes the same serious error that all of Appellant's witnesses make. *He and they persistently ignore the fact that Plaintiff's Exhibit 1, the contract between Appellant and Lloyd's, does apply, and always did apply, to the Tacoma Narrows Bridge as a single risk.* This fact is stated and re-emphasized again and again in Plaintiff's Exhibit 1 (Tr. 259).

The Appellant's witnesses all persist in referring to Plaintiff's Exhibit 1 as a *catastrophe cover*, intimating that it is the type of cover which cannot become effective unless there is some widespread, colossal catastrophe, which destroys or damages a large number of separate units or structures over a wide area. They all overlook the fact that Plaintiff's Exhibit 1 covered a loss to the Tacoma Narrows Bridge as a single unit and risk, even though no other properties were involved.

Furthermore, the Appellant's testimony as to custom does not, we submit, square with common sense or logic. Custom in any business which would sanction writing a contract in one way and then construing it in an entirely different and inconsistent way, would be absurd on its face.

If the theory advanced by Appellant's witnesses were correct, then the net retention warranty given by a ceding company to its reinsurer under a Treaty,

such as the Treaty involved here, would become utterly valueless. Under Appellant's theory a direct insurer might retain $500,000 upon a particular structure, which was not reinsured by pro rata reinsurance, and take out an excess of loss reinsurance contract covering $499,000 in excess of an ultimate net loss of $1,000, and then report and warrant to its contributing reinsurer a net retention of $500,000, whereas its actual net retention would be only $1,000. Under such circumstances reinsurers would have to ignore the net retention warranty given them by the ceding company and would have to form their own underwriting opinion of each and every risk ceded to them, which would be manifestly impractical, since the reinsurer would not have the information concerning the risk.

It is very significant to note that on cross-examination Mr. Beall, Appellant's vice president, was asked the following question and made the following answer (Tr. 233-234):

> "Q Would it make any difference—I will put it another way—assuming that the situation was reversed in this case; that the $50,000.00 of reinsurance had been ceded by the Union to the Northwestern, and the Union had told the Northwestern it would retain the $50,000—reversing the parties in the same contract—*would not your company have been concerned* if it found out subsequently to the cession that, although the Union had represented it was retaining $50,-000.00 net, that it had, without your previous knowledge, an excess catastrophe loss policy by virtue of which its top liability on the total loss

of the bridge from a single catastrophe was say $5,000, *would you be concerned with that?*

A *No, sir.* I am certain every company that cedes us reinsurance has a catastrophe contract which may reduce its loss." (Italics ours)

Mr. Beall further testified as follows (Tr. 234-235):

"Q Assuming a total loss on the Tacoma Narrows Bridge and the Northwestern being the reinsurer, the Northwestern would have to pay $50,000 in the case of a total loss in one catastrophe, and on the assumed facts I have given you, the Union, by reason of the $5,000 excess catastrophe policy, would only have to pay $5,000, would that not concern you?

A *Yes, sir; it would. We could not treat that as catastrophe reinsurance—an excess of $5,000.*" (Italics ours)

* * * * * * * * * *

"Q And that $5,000 maximum would result as $32,000 does here, from an excess catastrophe reinsurance, and you would be concerned with that difference between your $50,000 and the Northwestern's $5,000 on the bridge?

A If it was down to $5,000 I would be. *Because $5,000 is lower than the net retention carried by the Union. I would assume they had probably cut their retention on that risk.*" (Italics ours)

And so in the case at bar, *Appellant's excess of loss reinsurance contract with Lloyd's (Plaintiff's Ex. 1) cannot be considered as a catastrophe cover, since the attachment point ("ultimate net loss retention") of $30,000 is lower than the warranted net retention of $50,000 stated by Appellant to Appellee.*

On April 1, 1942, Appellee transmitted a letter (De-

fendant's Ex. A-11) to its various pro rata reinsurers, including Appellant, in which it announced a change in its excess of loss reinsurance policy, as follows (Tr. 238):

> "As of today, April 1, 1942, our Company has accepted the operation of a new Excess of Loss reinsurance contract whereby on some business outstanding, our net retention shall necessarily be different than entered on daily records corresponding, and also on certificates to your company upon pro rata reinsurance ceded.
>
> "Briefly, our new Excess of Loss reinsurance contract provides for a set minimum net loss retention by the Union of $4,800.00, each and every loss occurrence (not each and every risk), with an additional 10% loss possibility upon the provisional amount of excess of loss reinsurance.
>
> "Our outstanding pro rata reinsurances with your company should not generally be affected by above new Excess of Loss reinsurance setup; however, we shall appreciate and thank you for your agreement to such setup, by your endorsement of one of the two copies of the enclosed amendment for attachment to reinsurance agreement affected thereby."

Enclosed in this letter to Appellant (Defendant's Ex. A-11) was an instrument entitled "Amendment to Reinsurance Agreement," reading as follows (Tr. 239):

> "It is understood and agreed that, effective April 1, 1942, the Union shall have the right to carry Excess of Loss Reinsurance in respect to its own net retention upon risks written, and that, as regards pro rata reinsurances ceded by the Union prior to April 1, 1942, *the advised net*

> *retained line of the Union on any one risk shall not be considered as being reduced by any amounts recoverable from said Excess of Loss reinsurance.*" (Italics ours)

It would be expected, of course, that Mr. Beall and his company, in view of their present theory in this case, would have immediately answered Appellee's letter of April 1, 1942, stating that, since excess of loss reinsurance contracts must always be entirely disregarded in determining net retention under a Treaty, Appellant had no objection whatsoever to the change regarding excess of loss, and would therefore gladly sign the enclosed amendment to the reinsurance treaty. *But neither Mr. Beall nor Appellant did anything of the kind.*

On the contrary, on April 13, 1942, Mr. Beall, in behalf of Appellant, wrote Appellee (Defendant's Ex. A-10) stating (Tr. 237):

> "I have only just returned to Seattle from a trip to Chicago to attend a specially called meeting of the Federation, and I find our copy of your circular release addressed 'To Our Pro-Rata Reinsuring Companies.'
>
> "Now I want to confer with my associates before giving you our decision. *Frankly, I am much concerned about your new Excess of Loss Contract.* It was my understanding that you formerly carried Excess of Loss or Spread Loss above the first retention of $15,000.00.
>
> "*I am sure that we have in force many lines of reinsurance where our liability substantially exceeds $4,800.00. I am not happy about the possibility that we may be called upon to pay a loss of three or four times the net loss to your*

company. I will write you our decision in a short time." (Italics ours)

Appellant on page 24 of its brief contends that Plaintiff's Exhibit 2 (Tr. 125) shows that Appellee in a cession to Appellant, failed to give consideration to a catastrophe cover in stating its net retention. This exhibit contains a detailed schedule describing numerous buildings or risks in five different towns and two other locations. This is "blanket insurance." Upon each of these locations there is set a maximum liability which is less than the attachment point of the catastrophe cover. The catastrophe cover could not have been involved in the loss of any one unit or risk. There would have to be a total loss of all of these properties in a major catastrophe before Appellee's catastrophe cover would apply (Tr. 116-124).

On surrebuttal the Appellee, without waiving its continuing objection to extrinsic evidence on the question of custom and usage, produced the testimony of five experienced and disinterested witnesses who are among the foremost authorities in the United States on the subject of reinsurance. These witnesses were Mr. John D. Pryce, Mr. Frank H. Newman, Mr. Edwin Stewart, Mr. Walter J. Thompson and Mr. John Alden Towers.

These witnesses testified that, under the customs and usages of the insurance business, the term "*amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property*" (the term appearing in Article VIII of the Treaty) means *the maximum amount which the ceding company could lose out of its own pocket in*

the event of a total loss of the insured structure, taking into consideration all reinsurance, including excess of loss reinsurance such as Plaintiff's Exhibit 1. The term means the maximum amount that the ceding company would stand to lose out of its own pocket, without contribution by any other insurer, in the event of a total loss (Tr. 243, 245, 251, 260, 263, 264, 266, 286, 287, 300, 301, 316, 318, 336).

These witnesses further testified that, under the customs and usages of the insurance business, the Appellant in determining and stating its net retention on the Tacoma Narrows Bridge to Appellee was obliged to take into consideration, and make allowance for, its excess of loss reinsurance with Lloyd's (Plaintiff's Ex. 1). (Tr. 245, 264, 286, 301, 313).

In determining net retention the ceding company must always assume that the insured structure may be a total loss, and the determination is made on that basis (Tr. 161, 278, 287, 316, 336).

These witnesses further testified that, under the customs and usages of the insurance business, *the highest possible loss which Appellant could have sustained on the Tacoma Narrows Bridge, taking into consideration Appellant's reinsurance with Lloyd's (Plaintiff's Ex. 1) was $32,000, not $50,000, as stated by Appellant* (Tr. 246, 266, 302, 328, 329, 335, 338).

These witnesses further testified that, under the customs and usages of the insurance business, the Lloyd's policy (Plaintiff's Ex. 1), as applied to the bridge, constituted *excess of loss reinsurance* and *not* a "catastrophe cover," for the obvious reason that the

attachment point ("first loss retention") of the Lloyd's policy ($30,000) was less than the warranted net retention of Appellant on the bridge ($50,000) (Tr. 249, 254, 259, 261, 265, 268, 290, 312, 313, 314).

A true catastrophe cover is designed to protect the aggregate of a company's nets, and is customarily in excess of a very sizeable first loss retention, whereas Plaintiff's Exhibit 1 has an unusually low first loss retention for a company the size of Appellant—*a first loss retention which Appellant knew was below the amount ceded to Appellee on the Tacoma Narrows Bridge* (Tr. 252, 253, 261, 265, 310).

These witnesses further testified that, where parties to a reinsurance treaty intend to exclude excess of loss reinsurance from consideration in determining net retention, *they customarily insert a clause specificially so providing in the treaty* (Tr. 251, 287).

These witnesses gave several examples of treaty and contract provisions defining net retention. Some of these provisions provide, as does the Treaty here, that all reinsurance, including excess of loss reinsurance, *must* be considered in determining and stating net retention; others provide specifically that excess of loss reinsurance shall *not be considered* (Tr. 296, 297, 317, 321). *It is always a question of the particular contract* (Tr. 319).

Where, however, the treaty does not specifically exclude excess of loss reinsurance, *it must be considered* by the ceding company in determining and stating its net retention and *must be noted in the cession papers* (Tr. 153, 251).

Mr. John Alden Towers testified that since 1933 his office has issued periodical instructions to insurance companies cautioning them to specifically advise the markets to which they cede reinsurance of the existence of any excess of loss reinsurance, such as Plaintiff's Exhibit 1, which dips down into the net retentions warranted in their cessions (Tr. 324).

Had Appellant fully advised Appellee, at the time of the cession, of Appellant's excess of loss reinsurance (Plaintiff's Ex. 1), Appellee without doubt would have replied to Appellant's request to double its one risk maximum of $25,000, that Appellee preferred to make no exception in this case and would follow the $25,000 maximum limitation on cessions provided in the Treaty (Tr. 106, 273, 327-328).

Considering as a whole all of the expert testimony which has been introduced in this case on the meaning in the insurance business of the "*amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property*," as that term and definition is used in Article VIII of the Treaty, it seems to us that all of that testimony, insofar as it refers to this net retention clause, can be summarized as follows:

(1) The definition of net retention in Article VIII speaks for itself. It is couched in plain English. It is clear, definite, certain and unambiguous.

(2) The custom in the insurance business with respect to the interpretation of Article VIII is no different than the custom followed in other walks of life with respect to ordinary commercial contracts—

in other words, the wording of the particular contract governs. When insurance companies enter into reinsurance treaties and make or accept specific cessions of reinsurance, they define in the treaty, or in the application or correspondence covering the specific cession, the net retention that is to be maintained by the ceding company.

(3) When both parties intend that the ceding company may disregard excess of loss reinsurance in computing and stating net retention, the parties specifically so state, in clear and unmistakable terms, either in the treaty or in the papers governing the specific cession. The record in this case contains, as we have seen, examples of treaties and applications for specific reinsurance which specifically provide that excess of loss reinsurance shall be disregarded by the ceding company in computing and stating its net retention, and also examples by the terms of which excess of loss reinsurance must be considered by the ceding company in computing and stating its net retention. In the case at bar the Treaty contains no provision permitting Appellant to disregard its excess of loss reinsurance in computing and stating its warranted net retention.

(4) On the contrary, the parties to this case in their Treaty agreed upon a clear and specific definition of net retention which provides that it is the *amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property.*

It is obvious that the only reason for this lawsuit is the attempt by Appellant to read into this net

retention clause in Article VIII an exception which is not there—an exception, moreover, which is clearly precluded by the very clear terms of Article VIII.

Giving the testimony of Appellant's witnesses all the weight to which it may be entitled, it is obviously insufficient to support the burden of proof which Appellant necessarily assumed when it undertook to prove that there was a universal custom and usage which required interpretation of the Treaty contrary to its terms.

Appellant on page 25 of its brief, referring to the witnesses who testified for Appellee on the question of custom and usage, makes the following statement in italics:

> "* * * and not a single one of these witnesses testified that ever in his experience had he ever actually seen net retention computed by taking into account excess insurance of the type of defendant's Exhibit 1."

In making this assertion Appellant falls into very grave error indeed. The assertion is utterly unjustified. All of these witnesses testified that, under a definition of net retention such as that set forth in Article VIII of the Treaty, the custom and usage in the insurance business is for the ceding company to compute and state its net retention by taking into account excess of loss insurance such as Defendant's Exhibit 1.

Turning to page 250 of the transcript, for example, we find that Mr. John D. Pryce, one of Appellee's witnesses, testified as follows:

"Q When a company cedes a specific amount

of insurance to its reinsuring company, what is the custom in regard to advising that company of their various excess of loss policies?

A May I ask, do you mean under a treaty or a specific risk which is not covered by a treaty?

Q Under a treaty?

A If there is any excess of loss reinsurance covering the risk concerned the ceding company would or should mention the fact. If under a treaty then the treaty should itself state whether or not it is permissible for the ceding company to protect itself by excess of loss reinsurance.

Q Is that advice given on each daily report ceding specific insurance?

A Speaking for my office it is, unless it is under a treaty where such permission exists.

Q I am not referring to your office; I am referring to one insurance company dealing under a treaty with another insurance company?

A I believe it is customary.

Q Did you ever see such a daily report with that information on it?

A Yes I did."

Turning to page 319 of the transcript we find the testimony of Mr. John Alden Towers, a witness for Appellee, relating to various examples of definitions of net retention contained in treaties and contracts, some of them providing that *excess of loss* reinsurance shall be considered in determining net retention, and some of them providing that it shall be disregarded. Mr. Towers further testified as follows (Tr. 321):

"Q Have you in your experience seen daily reports or certificates of reinsurance of the

treaty reinsuring company to its reinsurers specifically mentioning such loss (excess of loss) as affecting net retention?

A I have."

On pages 25 to 28 of its brief, Appellant makes and reiterates a singular contention. Appellant contends that the witnesses for Appellee were inconsistent, in that they stated that, taking into consideration Appellant's excess of loss contract, Plaintiff's Exhibit 1, Appellant's "net retention" under Article VIII of the Treaty was $32,000, whereas they further stated that Appellant's "ultimate net loss on its net retained lines only," as defined in paragraph VI of Plaintiff's Exhibit 1 was $50,000. Appellant then remarks (Appellant's Brief, p. 28), that these witnesses indulged in "mathematical legerdemain."

This criticism is utterly without justification. Their is no inconsistency in this testimony. The term "ultimate nett loss of the reinsured company on its nett retained lines only," as used in the Lloyd's policy (Plaintiff's Ex. 1), and the term "*amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property,*" as used in Article VIII of the Treaty, are by definition in the documents themselves two entirely separate and distinct things, as the record clearly shows (Tr. 32, 198, 199, 204, 206, 210, 259, 260, 282).

The Lloyd's policy starts paying only when Appellant has first paid or become liable for $30,000 in one loss. Lloyd's then pays 90% of the excess of Appellant's loss over $30,000. Obviously Lloyd's, in computing this excess, does not first deduct the amount

it is going to pay. Hence Lloyd's, in the event of total loss of the Tacoma Narrows Bridge, would compute Appellant's total loss as $50,000, and the excess over the first loss retention as $20,000.

Appellant closes its brief (page 51) with a series of questions. Appellant states:

> "Furthermore, if excess of loss reinsurance such as Plaintiff's Exhibit 1 (Finding XVI, Tr. 79) must be deducted in order to arrive at 'net retention' what sum is to be deducted?"

Appellant then propounds six questions. Only one of these questions merits an answer, namely No. (3), which reads:

Is it

> "$18,000, the amount which Appellant would realize on a total loss of this bridge, unconnected with any other loss?"

The answer, of course, is *that Appellant should have deducted $18,000, the amount it knew it would receive from Lloyd's on the bridge in the event of a total loss.*

From the inception of this controversy until the present time the Appellee's position has consistently been that under Article VIII of the Treaty it was the duty of Appellant in determining its net retention on the Tacoma Narrows Bridge to frankly state its maximum liability with respect to this bridge in the event of a total loss. By virtue of the existence of Plaintiff's Exhibit 1, the maximum amount which Appellant would have to pay out of its own pocket in the event of a total loss of the bridge, was only $32,000, because it would receive $18,000 (90 per cent of the excess of $50,000 over $30,000) from

Lloyd's under the terms of Plaintiff's Exhibit 1. The Appellant should therefore have notified the Appellee when the cession was made that its net retention under Article VIII was $32,000.

Furthermore, it is important to note that the maximum amount of Appellant's liability on the bridge in the event of a total loss to the bridge would be $32,000, *even though the loss of the bridge might be accompanied by the loss of a number of other structures, all insured by Appellant, in the same loss.*

This is well illustrated by the testimony of Mr. Towers (Tr. 333-334). Mr. Towers testified that if on November 7, 1940, a windstorm had totally destroyed the Tacoma Narrows Bridge and had also destroyed at the same time another bridge in the same vicinity, and assuming that Appellant had insured both bridges in the same manner that it insured the Tacoma Narrows Bridge—namely a $350,000 coverage on each bridge which had been reduced by specific reinsurance to $50,000 on each bridge—the ultimate loss which Appellant would have had to pay on both bridges would be $37,000—that is to say, there would have been a total loss of $100,000, and Lloyd's under the provisions of Plaintiff's Exhibit 1 would have paid 90 per cent of that loss over $30,000, or $63,000, and Appellant would have paid out of its own pocket $30,000, plus 10 per cent of $70,000 or $37,000. Since there were two bridges in the assumed case, one-half of Appellant's loss of $37,000, namely $18,500, would be allocated by Appellant to each of the two bridges.

If a third bridge, similarly insured by Appellant, were assumed to be totally destroyed at the same

time and in the same windstorm, the loss that would be allocated to each of the three bridges would be $14,000 (Tr. 333-335).

It is therefore obvious that the following proposition is incontrovertible, namely: *That, taking into consideration Appellant's excess of loss contract (Plaintiff's Ex. 1) $32,000 was at all times Appellant's absolute top liability (i. e. net retention) in the event of total destruction of the Tacoma Narrows Bridge; and this proposition holds true even though we assume that one or more additional bridges or structures might likewise be totally destroyed in the same loss.*

The remaining five questions which Appelant presents on page 51 of its brief have nothing whatsoever to do with the point at issue or with this case, and are merely thrown in to suggest confusion on a point where no confusion whatever actually exists.

For instance in question No. (1) Appellant asks whether, in determining net retention under Article VIII of the Treaty, we should deduct "$153,000, the maximum amount of the excess insurance." In other words, Appellant is asking whether $153,000 should be deducted from $50,000. The question is absurd and the answer is of course "no." The answer to the remaining four questions, which are equally absurd, is also emphatically "no."

All of these questions, with the single exception of question No. (3), are purely arguments in the form of questions, but they are patently fallacious arguments having no relevancy to the issue, and constitute, we submit, unjustified criticism of the District Court's Finding XVI (Tr. 79).

(3) The Evidence Establishes That Appellee Had No Notice or Knowledge of the Appellant's Failure to Correctly State Its Net Retention Until After the Loss of the Tacoma Narrows Bridge.

As we have heretofore noted, Appellant failed to advise Appellee of Appellant's actual net retention ($32,000) on the Tacoma Narrows Bridge until a date subsequent to the loss of the bridge. It was on August 25, 1941, that Appellee received the first intimation that Appellant's net retention was less than $50,000 as warranted (See Defendant's Ex. A-6, Tr. 104-105).

Clearly Appellant, which was at all times under the legal obligation to exercise the highest good faith toward Appellee, cannot offer any valid excuse for its failure to correctly state its net retention when it made the cession to Appellee, or for its failure to advise Appellee at the time of the cession that its actual net retention was $32,000.

At the trial Appellant made what is, in our opnion, a very strained effort to excuse its failure in this regard by contending—and offering some evidence in support of the contention—that Appellee, despite Appellant's failure in this regard, might have advised itself through other sources of the existence of Plaintiff's Exhibit 1, and of Appellant's actual net retention on the Tacoma Narrows Bridge under Article VIII of the Treaty. Appellant stresses this contention on pages 43 to 49 of its brief on this appeal.

Appellant mentions three sources from which it argues this information might have been obtained by Appellee: (1) From a conversation in 1928 between

Mr. Beall and Mr. Easton, a former officer of Appellee; (2) From a statistical publication called "Best's Reports," and (3) From official reports covering Appellant and its business on file with the Insurance Commissioner of the State of Washington.

1 Let us consider first the conversation with Mr. Easton. Mr. Beall, Appellant's vice president, testified that in the year 1928, twelve years prior to the execution of the treaty involved in this suit, he had a conversation with Mr. Easton, at that time an officer of Appellee, but since retired (Tr. 225). Mr. Beall stated the conversation took place in Milwaukee at an insurance convention, and that he and Mr. Easton had a discussion of their underwriting programs and their theories along this line, and of reinsurance which each company carried (Tr. 226-228). In other words, Mr. Beall and Mr. Easton had a general conversation concerning their underwriting programs and their reinsurance programs as they existed in 1928, twelve years prior to the execution of the Treaty in suit, and twelve years prior to the cession by Appellant to Appellee of the reinsurance on the Tacoma Narrows Bridge.

To us it seems incredible that a company occupying the fiducial relationship Appellant occupied, could seriousy offer this vaguely remembered, twelve-year-old conversation at a convention as a valid reason for Appellant's failure to comply in good faith with Article VIII of the Treaty of January 1, 1940.

2 Let us next consider Best's Reports. Best's Reports is a privately published statistical publication. At the

trial counsel for Appellant interrogated Mr. Legris, Appellant's assistant secretary, concerning a particular volume of Best's Reports, which applied to annual statements furnished by insurance companies as of December 31, 1939, but which was not issued by Best's Publications until May of 1940 (Tr. 140). Counsel for Appellant referred to page 991 of that volume, which recited that Appellant had very satisfactory arrangements under reinsurance treaties for reinsuring excess lines, besides carrying a first excess catastrophe coverage for $200,000 applicable to all hazards in excess of $30,000, and a second excess over $250,000 up to $500,000 (Tr. 138).

The practice of the Best's management in securing data for the Reports, is to send out to the companies each year a request for the information that is published. The companies furnish Best's management with a copy of their annual statements and send additional information on forms submitted by Best's. In each case it is the company itself which writes out the script and sends it to Best's management, and Best's management for the most part publishes what each company sends it (Tr. 151-153, 271-272).

A reinsuring company, such as Appell~~ant,~~ee in passing upon the question of whether it will accept a particular cession of reinsurance, does not consider Best's Reports at all (Tr. 136, 153, 272, 306, 331-332). Neither Best's nor any other publication is authoritative in this connection (Tr. 27). The reinsuring company analyzes the proposed cession of reinsurance on the face of the information contained in the particular binder, daily report or certificate of rein-

surance, and if everything is correct on the face of those papers, in the judgment of the underwriting department of the reinsuring company, the cession is approved (Tr. 136, 153, 272, 306).

Mr. John Alden Towers testified that Best's Reports are not used in considering cessions; that there are other books similar to Best's, namely, The Spectator, The Argus Field, and The Weekly Underwriter; that these publications could not be used for cessions, because it is presumed that companies dealing between themselves know more about the position of each company than Best's would know, and that, under the customs and usages of the insurance business, reinsurance is placed as provided in the treaty contract and in accordance with a cession or binder notice, daily reports, or bordereaus (monthly reports in writing). (Tr. 331-332). Furthermore, as noted, Best's 1939 Reports did not come out until May of 1940. Therefore, the information contained in that book was cold and too old to be of any use when Appellant made its cession of reinsurance to Appellee, which is a further reason why Best's obviously would not be referred to for purposes of reinsurance, but only for names and initials of officers, titles of companies, addresses, and annual statement figures for the preceding year.

If ceding companies, owing the legal duty of the highest good faith to their reinsurers, could avoid their legal obligation to make full and frank disclosures on their daily reports or other papers by which the cessions are made, by offering excuses such as Appellant offers here, then reinsurance treaties would

become utterly worthless, and reinsurers would have to maintain an espionage department to check and sift chance conversations at conventions, magazines, periodicals, newspapers and street rumors from day to day during the entire life of the reinsurance treaty.

For the Appellant to have relied upon the happenstance that the company to which it was ceding $50,000 of reinsurance might perhaps delve into independent statistical publications or chance conversations between individuals and accidentally discover for itself what Appellant's actual net retention on the bridge was, would be a strange way indeed for a ceding company to fulfill its obligation of the highest good faith, particularly when we consider that Appellant at the time it made the cession could have very easily and very briefly stated the facts to which Appellee was entitled.

Let us turn now to the third excuse given by Appellant for not complying with its obligation to state its actual net retention and to fully advise Appellee of the existence and effect of Plaintiff's Exhibit 1. The third excuse is that Appellee could have secured this information by examining the official insurance reports covering Appellant on file with the Insurance Commissioner of the State of Washington. 3

Mr. Sullivan, a witness called by Appellant, testified (Tr. 190, 194) that he was familiar with the examinations made of domestic insurance companies by the Insurance Department of the State of Washington, having served in that department for nine years. Mr. Sullivan testified that in the State of Washington

these examinations were made annually; that every three years there was an examination made under the auspices of the National Insurance Commissioners' Association by examiners from outside states who were invited to participate with the Washington examiners. He further very positively testified that these examination reports revealed the existence of the catastrophe policies and the *amounts of reinsurances and risks* carried by the domestic companies and *explained them rather fully, summarizing their terms and giving their limits* (Tr. 190, 194).

Now, then, *what are the facts in this regard?*

Appellee in surrebuttal introduced in evidence the following very important exhibits (Tr. 360-363, 396-402): (1) *Defendant's Ex. A-14*, an exemplified copy of the entire report of examination of Appellant by the National Association of Insurance Commissioners, dated December 31, 1938; (2) *Defendant's Ex. A-15*, an exemplified copy of the entire report of examination of Appellant by the Insurance Commissioner of Washington, dated December 31, 1939; and (3) *Defendant's Ex. A-16*, an exemplified copy of the entire report of examination of Appellant by the Insurance Commissioner of Washington, dated December 31, 1940.

The originals of these three exhibits have been transmitted to and filed with this Court by order of the District Court. *These three exhibits speak for themselves and conclusively establish that Mr. Sullivan's testimony regarding these reports was utterly without basis. There is not a single word in any of these bulky reports "explaining" the excess of loss*

contracts or catastrophe covers of Appellant; and there is not a single word in any of these exhibits which states or "summarizes" the terms or gives the limits of these excess of loss contracts or catastrophe covers.

So much for Appellant's efforts to excuse its failure to comply with Article VIII of the Treaty. There is a plain answer to these excuses which Appellant offers, and that answer is this: A fiduciary cannot avoid its obligations by such specious arguments as these; that Appellant's obligation was *to speak out—to speak out immediately in clear and unmistakable terms*—regarding the true amount of its net retention on the Tacoma Narrows Bridge; and that, having failed to do so, it cannot now object to adjustment of Appellee's liability under Article XIV of the Treaty.

> *"The parties were not dealing at arm's length. Under the contract Plaintiff occupied a fiduciary position demanding fairness and open disclosure of all reinsurance reducing its agreed retention of risks."* * * *
>
> *Columbia National Fire Ins. Co. v. Pittsburg Fire Ins. Co.* (Mich.) 210 N.W. 258.

> "While excess cover may be used by a reassured, it ought to inform its reinsurers of any action taken by it in this connection, so that reinsurers can always have knowledge of the reassured's self-retentions under a treaty * * *."
>
> Thompson on Reinsurance, page 113.

In view of the Treaty, Appellee had an absolute legal right to reply upon, and to assume the correctness of, the net retention as stated and warranted by Appellant in its cession to Appellee.

Appellee was not obligated in any way to go beyond the daily report and wires (Tr. 92-94) which effected this cession and make an independent search to see if perchance it might discover through outside sources that Appellant's solemn written warranty was not true, and that Appellant might perhaps be withholding material information.

Not only was Appellee not legally obligated to do this, but such a practice would obviously be an impossibility in the practical operation of the reinsurance business. In view of the vast amount of reinsurance written, covering all the states of the Union, and the vast amount of detail involved, the reinsurer must necessarily rely upon the good faith of the ceding company and the correctness and completeness of its written statements and warranties.

The established custom is for the reinsured to accept on its face the information and net retention stated by the ceding company on its cession papers (Tr. 136, 153, 258, 306).

(4) Appellant's "Two-risk" Theory and Its Contention Regarding "P. M. L." Are Clearly Contrary to the Preponderance of the Evidence.

Appellant at the trial, and in the brief which it has filed in this Court, makes another contention. (See pages 35 to 42 of Appellant's brief). Appellant contends that when it wrote the insurance on the Tacoma Narrows Bridge it concluded that the bridge constituted "two risks" (Tr. 222). Appellant contends in effect, that when it made the $50,000 cession of reinsurance to Appellee, its intention was to cede

to Appellee $25,000 on each of the two alleged separate risks, and that, since the attachment point of the Lloyd's policy (Plaintiff's Ex. 1) was higher than $25,000, Appellant did not violate Article VIII of the Treaty in failing to consider plaintiff's Exhibit 1, when it computed and advised Appellee that its net retention under Article VIII was $50,000.

Mr. Beall testified (Tr. 222):

> "Q How many risks did you underwrite the bridge as?
>
> A As two risks."

The basic fallacy inherent in this "two-risk" theory is that it entirely fails to meet the real issue presented by Appellee's answer in this case (Tr. 58). Appellant is suing to recover upon a particular written contract—the Treaty of January 1, 1940—(Tr. 28), a contract which is clear, definite and complete on its face. Appellant is therefore *bound* by the terms of that contract.

That contract, in Article VIII, very clearly states that Appellant in making the cession of reinsurance to Appellee shall not cede more than *the amount retained net without reinsurance by the reinsured company at its own risk and liability on the same property*. That means, in the present case, that Appellant was forbidden by the Treaty to cede to Appellee more than the amount which it retained net at its own risk and liability on one particular structure, constituting a single, component unit, namely, *the Tacoma Narrows Bridge*.

It is clearly established by the evidence that, contrary to Appellant's warranty, all that Appellant re-

tained net without reinsurance at its own risk and liability on the same property, that is, on the Tacoma Narrows Bridge, was $32,000 (Tr. 111, 147, 160, 180, 193, 246, 266, 302, 328, 329, 335, 338).

The very clear meaning of Article VIII is that Appellant must retain an "equal stake" with Appellee, "*on the same property reinsured by the said reinsured company with the reinsuring company.*"

If Appellant cedes $50,000 to Appellee on the bridge as a single, component unit then it must necessarily retain $50,000 at its own risk and liability *on the same property*—that is—*on the bridge, as a single, component unit.* For Appellant to now say, as it does in its hair-splitting "two-risk" theory, that what it really did, or meant to do, was to theoretically divide this single-span, suspension bridge into two undefinable parts, and cede Appellee $25,000 on each of these undefinable and inseparable parts, just as though they were two entirely separate structures located miles apart, is clearly beside the issue.

Appellant, in advancing this "two-risk" theory disregards Article VIII of the Treaty, which is the contract it is suing on. Appellant disregards the positive mandate of Article VIII that it must retain the identical amount that it cedes *on the same property, i. e., on the Tacoma Narrows Bridge as one unit.* Appellant ceded $50,000 *on the bridge as one unit;* therefore, it had to retain $50,000 at its own risk and liability *on the bridge as one unit.* This it did not do.

According to Appellant's "two-risk" argument, it could have ceded to Appellee with perfect propriety, under Article VIII, $75,000 on the bridge as one unit,

warranting to Appellee that it was itself retaining net, *on the same property as one unit,* without reinsurance, "*identical $75,000,*" and could then reinsure, on an excess of loss basis, all but $25,000 of the $75,000, on the theory that the bridge in Appellant's mind constituted three undefinable risks, each representing $25,000.

Of course, in such a case, Appellee would stand to lose $75,000 in the event of total loss of the bridge, whereas Appellant would stand to lose only $25,000. Yet, according to Appellant's argument, this would all be perfectly proper because Appellant in its own mind concluded (but did not disclose to Appellee) that there were "three risks."

Likewise, the "two-risk" theory is contrary to all that Appellant has said and done prior to the loss of the Tacoma Narrows Bridge. The two-risk theory is but another attempt by Appellant to amend and modify by extrinsic evidence, the very clear written record it has made—a written record which squarely refutes its present theory.

In view of this two-risk contention, let us re-examine for a moment Defendant's Exhibit A-5 (Tr. 94), which is the instrument (Daily Report No. 10852) by which Appellant ceded to Appellee the $50,000 of reinsurance on the bridge.

Does Defendant's Exhibit A-5, which was transmitted by Appellant to Appellee in June, 1940, state or indicate in any way that Appellant has concluded that the Tacoma Narrows Bridge constituted two separate risks? The answer is emphatically "no."

Does Defendant's Exhibit A-5 state or indicate in any way that Appellant is ceding to Appellee a maximum of $25,000 on each of two separate risks? The answer is again emphatically "no."

On the contrary, Defendant's Exhibit A-5 merely states that Appellant is ceding to Appellee $50,000 of reinsurance *on the Tacoma Narrows Bridge and approaches*, and that Appellant is retaining "*identical $50,000.*"

There is certainly nothing ambiguous about "*identical $50,000,*" and it does violence to all rules of reason and logic for Appellant now to contend that by virtue of its present two-risk theory it had a right to retain net only $32,000, in the face of its express warranty to Appellee that it was retaining net "identical $50,000." There can be no two interpretations of the word "*identical;*" the only net retention that could be identical with $50,000 is $50,000.

No matter what Appellant and its witnesses may now say, with respect to any thought or intention that Appellant and its agents may have had in the inner recesses of their minds as to whether the bridge constituted one risk or two risks, the indisputable fact is that Appellant's cession to Appellee must be determined *on the face of Defendant's Exhibit A-5 itself.*

Defendant's Ex. A-5 (Tr. 94) constitutes the cession; and no undisclosed thoughts or intentions that existed, if they did exist, in the mind of Appellant, can in any way change or alter that instrument.

Furthermore, it seems clear from the record that

Appellant's present contention that it ceded to Appellee $25,000 of reinsurance on each of two separate risks, is purely an afterthought.

An examination of the Treaty will show that Appellant had an absolute right to cede reinsurance on the Tacoma Narrows Bridge to Appellee, without asking for or securing Appellee's special consent in advance, provided of course that Appellant strictly complied with Article VIII of the Treaty. *Therefore, if Appellant's present two-risk theory of the cession had been in its mind at the time the cession was made, there would have been no reason in the world why Appellant should have written Appellee requesting its special consent in advance to the cession of $50,000.* 4

Yet we find that on May 31, 1940, Appellant wrote a letter to Appellee asking it to give its advance consent to the proposed cession of $50,000 (Tr. 40).

Not content with this letter, Appellant on June 10, 1940, sent a wire to Appellee (Defendant's Ex. A-1, Tr. 92), asking Appellee to answer Appellant's letter of May 31 and to wire authorization of the proposed cession. This wire contains the clear, concise statement "*we will retain $50,000.*" Nothing whatever is said in the wire indicating that Appellant at that time had in mind its present theory that it intended to cede to Appellee $25,000 on each of two separate risks.

On June 11, 1940, Appellee wired Appellant (Defendant's Ex. A-3, Tr. 93) authorizing cession of $50,000.

It is, of course, obvious that there was but one possible reason for Appellant asking, as it did, in the

above mentioned letter and wire for Appellee's special consent in advance to the cession of $50,000—and that reason was that Appellant was ceding Appellee $50,000 on one risk, and in as much as that cession was twice as much as the $25,000 top limit for a one-risk cession, prescribed in Article VIII of the Treaty, Appellant knew that it had to secure Appellee's special consent in advance.

This is conclusively established by Appellant's letter of December 29, 1941, to Appellee, where Appellant states (Tr. 43, 44):

> "However, we note in Article VIII of the Reinsurance Agreement that *the limit of each risk is expressly subject to the exception of 'specific cases subject to the approval of the reinsuring company.'* The files in this case disclose that the association on May 31, 1940, sent to each of their various reinsurers, among which was your company, a circular specifically describing this bridge as a single span suspension bridge. They received numerous specific authorizations from various reinsurers, but not having received any from you, on June 10, 1940, they sent a telegram to you, in which they asked that you *'please wire your authorization.'* You replied to this telegram by specific authorization of $50,000, following it up by a letter of confirmation.
>
> "We would therefore earnestly urge upon you their cession to you of $50,000 reinsurance *clearly comes within the exception of a specific case subject to your approval.*" (Italics ours)

It will be noted that the District Court in its Findings of Fact VI (Tr. 69) found:

> "That, in as much as the maximum amount

which the plaintiff could cede to the defendant on one risk under Article VIII of the Treaty was $25,000, and since the plaintiff desired to cede to the defendant more than said maximum amount of reinsurance on the Tacoma Narrows Bridge, plaintiff on June 10, 1940, wired the defendant asking for specific authorization to do so."

The District Court in its Findings VIII (Tr. 70) finds:

> "That said cession by the plaintiff to the defendant was a cession of $50,000 of reinsurance upon the Tacoma Narrows Bridge and approaches as one unit and risk, the single-risk maximum of $25,000, designated by Article VIII of said Treaty, being increased to $50,000 by the above mentioned specific authorization and approval of the defendant, pursuant to and in accordance with the provisions of Article VIII of said Treaty permitting this to be done in specific cases subject to the approval of defendant. That the court finds said reinsurance was not ceded to the defendant upon a two-risk or multiple-risk basis, but, on the contrary, was ceded on a one-risk basis."

The Appellant did not produce at the trial any contemporaneous record or written evidence supporting its claim that in June, 1940, it underwrote the bridge as "two risks."

Moreover, if Appellant's two-risk theory is not an afterthought, *why did not Appellant immediately and forcefully advance this two-risk argument when replying to Appellee's letter of September 8, 1941* (Defendant's Ex. A-7, Tr. 96), wherein Appellee asks why Appellant in its proof of loss had stated that its

net loss was $38,461.54 *"prior to excess?"* Appellant then knew that it was being called to task by Appellee for not properly stating its net retention. The most natural thing in the world, if Appellant had then had the two-risk theory in mind, would have been to immediately write to Appellee stating clearly and emphatically, "We underwrote the bridge on a two-risk basis; we ceded to you $25,000 on each of two separate risks; and therefore, our excess of loss reinsurance does not apply to our net retention." Appellant, however, in replying to Appellee's letter of September 8, 1941, *made no such statement.* On October 1, 1941, Appellant by letter answered Appellee's letter of September 8 and it *said nothing whatsoever about its present two-risk theory* (See Defendant's Ex. A-8, Tr. 97).

Again on October 15, 1941, Appellant wrote Appellee endeavoring to explain why it had not considered its excess of loss policy in determining its net retention (Tr. 49-51). Again Appellant had an opportunity, if it had then had the two-risk theory in mind, to speak out clearly and tell Appellee about it in clear and unequivocal terms. *It did not do so.* On the contrary, the terms of the letter clearly negative any possible two-risk theory, because the letter states among other things (See Appellant's Admission, Tr. 49, 50):

> "In the *ordinary case*, of course, the question would never arise in any event *since the amount we would retain net on one risk would be considerably less than the $30,000 limit in our excess catastrophe contract. * * * We ceded to you $50,000 on your specific authorization*, and it is our

conscientious opinion that your payment should be predicated on that amount, and should not be influenced by the existence of our catastrophe excess contract." (Italics ours)

Furthermore, how can a single-span suspension bridge of this type be reasonably or logically considered as "two separate risks?" It is obvious that if one pier collapsed it would most certainly collapse the entire bridge. Except for the approaches, which constituted only about 2% of the total value of the bridge, the bridge was all clearly subject to loss from one and the same occurrence, whether due to windstorm, collapse or other causes, all covered by Appellant's policy on the bridge (See Defendant's Ex. A-8, Tr. 97).

Mr. Beall, Appellant's vice president, was asked on cross examination to give his segregation or description of the alleged "two risks" and he was utterly unable to do so (Tr. 232).

As Mr. Towers testified: *"You cannot make black out of white."* The entire bridge constituted one component structure and one risk; and was ceded by Appellant to Appellee as one risk by Daily Report No. 10852 (Defendant's Ex. A-5, Tr. 94).

"Single risk," as Mr. Towers testified, has been defined by stating what constitutes more than one risk, *i.e.; "two properties unlikely to be affected in the same occurrence would be considered as more than one risk"* (Tr. 345).

The National Federation of Mutual Fire Insurance Companies in its Bulletin, Vol. 21, No. 2, transmitted to its various members, including Appellant, contains

an authoratitive definition, from a consensus of opinion source, of the term "*one risk*" as follows (Tr. 358):

> "'*The same risk*' refers to one fire area *and not to the probable maximum loss.* For instance, the probable maximum loss on a fire resistive building might be 50%, but the building might still be all in one fire area. In such a case the building would constitute *one risk.*" (Italics ours)

By the same token the Tacoma Narrows Bridge constituted one risk, and that is why the reinsurance covering it was ceded as one risk by Appellant in Daily Report No. 10852 (Defendant's Ex. A-5, Tr. 94).

Mr. Towers testified:

> "My answer is that you cannot make black out of white, and that even though the ceding company is the sole judge of what constitutes one risk, that does not give it the right to cede what would be customarily called one risk as two risks; and the fact that the ceding company wired for permission to exceed the limit named in the Treaty of $25,000, indicates quite strongly that the ceding company realized most underwriters would consider this one risk." (Tr. 348)

The Appellant, apparently realizing the weakness of its two-risk theory, contends that the term "P. M. L.," which means "probable maximum loss," as used in its daily report No. 10852 (Defendant's Ex. A-5, Tr. 94), was a symbolic declaration to Appellee that Appellant had underwritten the bridge on a two-risk basis and was therefore in effect ceding to Appellee $25,000 on each of two separate risks.

In support of this contention Appellant at the trial undertook the burden of proving, over Appellee's continuing objection, that it was the universal custom known to all insurance companies to use the "P.M.L." designation to indicate the number of risks, and that therefore the Court should read into Appellant's daily report (Defendant's Ex. A-5) some such declaration as this: "Northwestern finds that the bridge constitutes two risks, and therefore cedes to Union under the treaty $25,000 on each of said risks."

Appellant's witnesses testified that they had followed such a practice, but the witnesses called by the Appellee, Messrs. Legris, Pryce, Newman, Stewart, Thompson and Towers, all outstanding men of wide experience in the reinsurance business, testified positively and emphatically that there was no such custom and usage (Tr. 107, 116, 135, 247, 266-7, 288, 302-3, 329-30).

Here again, the burden of proof was squarely upon Appellant to prove by a preponderance of the evidence that there was a custom to this effect, and that the custom was so universal that the Court must conclusively presume that it was known to both parties and actually relied upon by them.

It is a significant fact that Appellant found it necessary, in order to pursue its cause of action in this case, to attempt to rewrite not only the Treaty (Tr. 28), but also its daily report No. 10852 (Defendant's Ex. A-5, Tr. 94). This becomes all the more significant when we consider that Appellant's lawsuit is squarely based on the very instruments which it now seeks to rewrite.

These witnesses testified that, under the customs and usages of the insurance business, the designation "P.M.L." followed by a percentage figure, refers to the *quality* of the risk and means the "probable maximum loss" in the opinion of the underwriter on a particular cession. The designation may apply to one risk or to more than one risk. Two identical, single-risk structures may have entirely different P.M.L. designations based upon differences in location, fire protection facilities, etc. The designation indicates the maximum "damageability" of the risk from the peril insured against (Tr. 107, 116, 135, 247, 266, 288, 302, 329).

Under the customs and usages of the insurance business the "P.M.L." designation is not used to indicate the number of risks involved in a particular cession of reinsurance (Tr. 107, 116, 135, 247, 266, 288, 302, 329).

According to the National Federation of Mutual Fire Insurance Companies: "*'The same risk'* refers to one fire area *and not to the probable maximum loss*" (Tr. 358).

These witnesses further testified that, under the customs and usages of the insurance business, ceding companies, under reinsurance treaties, customarily indicate the number of risks involved, where there are more than one, by making separate cessions (Tr. 116, 248, 267, 331).

Where, however, two or more risks are included in one cession the ceding company lists or describes the several risks in the cession papers or bordereau (Tr. 116, 248, 267, 289, 303).

If, as Appellant undertook the burden of proving, it is the universal custom and usage in the insurance business, for ceding companies to employ the term "P.M.L." to designate the number of risks, is it conceivable that outstanding authorities with years of experience in the insurance business, such as Messrs. Pryce, Newman, Stewart, Thompson and Towers, who have handled thousands of cessions and hundreds of treaties over a long period of years—and all of whom are entirely disinterested—could have had no single experience where "P.M.L." was used to designate the number of risks?

Appellant has clearly failed to introduce sufficient evidence on this point to prove by a preponderance of the evidence that its alleged custom with respect to the use of P.M.L. actually existed, and was so universal that the Court must now conclusively presume that both Appellant and Appellee knew of it, relied upon it, and acted with reference to it.

Mr. Beall, Appellant's Vice President, on cross examination testified that the caption "P.M.L." appearing upon Daily Report 10852 (Defendant's Ex. A-5) indicates that there is more than one risk involved; that 50% P.M.L. would indicate two risks, 33 1/3% three risks and 25% four risks (Tr. 229, 232). Such is the yardstick which Mr. Beall states his company uses in stating P.M.L. By the same token it would necessarily follow that five risks carried a P.M.L. designation of 20 per cent—ten risks 10 per cent, etc.

If we turn, however, to Defendant's Exhibit A-17 (Tr. 364), the group of eleven daily reports wherein Appellant ceded reinsurance to Appellee, we find that

they do not square with Mr. Beall's testimony mentioned above.

For instance, in Daily Report 9108, contained in that exhibit, the P.M.L. was stated to be 33 per cent, although the cession covered seventeen separate items or risks. If the above mentioned testimony of Mr. Beall were correct, then the P.M.L. should have been stated at 5.9 per cent, instead of 33 per cent.

Take for another example, Appellant's Daily Report 13486 appearing in the same exhibit. In this report the P.M.L. was stated to be 60 per cent, yet the report covered twenty-one separate locations or risks in sixteen towns. If Mr. Beall's testimony were correct, then the P.M.L. should have been stated as 4.5 per cent instead of 60 per cent.

If a custom and usage regarding P.M.L., such as Appellant now contends for, could be conceived of, even as a possibility (the evidence clearly shows that it does not exist as a matter of fact), it would manifestly be an unreasonable custom. Its very unreasonableness on its face is the best argument against the possibility of its existence. It simply does not appeal to our common sense or sense of justice to say that a ceding company, in view of its obligation of the highest good faith, can escape its legal obligation, as a fiduciary, to make a full disclosure of all material facts (one of the most important of which is the number of risks involved, if more than one) by clinging to this slender straw of P.M.L., when it would have been such an exceedingly simple matter for Appellant to have plainly and frankly said in its daily report in a single, short sentence: "Bridge un-

derwritten as two separate risks of $25,000 each; and $25,000 is ceded on each risk."

> "A fundamental rule of reinsurance, * * * the foundation of reinsurance, is—
>
> "(1) Full information, so far as possessed by the ceding company, as to the risk on which the reinsurance is requested. * * *."
>
> Golding, "The Law and Practice of Reinsurance," p. 14.

We respectfully submit that the Findings, Conclusions and Judgment of the District Court are clearly supported by the great preponderance of the evidence in this case; and that the Judgment should be affirmed.

Respectfully submitted,

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